

DRAFT FISCAL NOTE

REQUEST NO.

RESPONDING AGENCY:	CODE:	DATE:	BILL NUMBER:
Office of the State Actuary	035	11/29/06	LEOFF 2 Annuity Purchase

SUMMARY OF BILL:

This bill impacts the Law Enforcement Officers' and Fire Fighters' Retirement System Plan 2 (LEOFF 2) by allowing members and survivors to purchase life annuity benefits from the LEOFF 2 retirement fund.

Effective Date: 90 days after session

CURRENT SITUATION:

A LEOFF 2 member is currently allowed, upon retirement, to purchase up to 5 years of additional service credit. Since this service credit is not based on any service rendered, it is commonly referred to as "air time". The member must pay the actuarially equivalent value of the service; this is the same as purchasing an annuity that will provide up to 10 percent of the member's final average salary for their lifetime.

Members of the Public Employees', Teachers', and School Employees' Retirement Systems Plans 3 may currently purchase Total Allocation Portfolio (TAP) annuities. Annuities for members in the Plan 3 Self-Directed investment program have been available since 1997. TAP annuities can be purchased when a member is eligible to withdraw funds from their Plan 3 defined contribution (DC) account.

MEMBERS IMPACTED:

We estimate that all 15,168 members of LEOFF 2 could be affected by this bill. We estimate that for a typical member impacted by this bill, the value of any additional benefits purchased will be completely offset by the cost to the member of purchasing the annuity.

ASSUMPTIONS:

We assumed that the member would pay the full actuarial value of the annuity purchase. We have also assumed that the full actuarial cost will include the cost of any adverse selection that may develop due to mortality experience. We have further assumed that this benefit proposal will not change future retirement behavior in the plan since existing members currently have access to private-sector annuity providers that provide similar annuity products.

FISCAL IMPACT:

None. There would be no impact on rates if the member pays the full actuarial value of the annuity purchase.

It is possible that healthier than average members could benefit from this bill by outliving their assumed life expectancy. If only healthy members purchased annuities it is possible that there could be a minor cost for this benefit. However, we feel that this is unlikely, as in general there is no certain way for people to know whether or not they will outlive their life expectancy. While the mortality experience of the members electing to purchase an annuity should be monitored to compare it to the mortality experience of the entire group, the number of members electing this benefit will most likely be too small to make a determination about their mortality experience, and it could take decades to accumulate mortality data on the members electing to make the purchase.

This benefit is a variation of the benefit which allows members to purchase additional service by paying the full actuarially equivalent value of the additional benefits. We assume that benefits for which the member is required to pay the full actuarial cost have no significant impact on the cost of the plan.

STATEMENT OF DATA AND ASSUMPTIONS USED IN PREPARING THIS FISCAL NOTE:

The costs presented in this fiscal note are based on our understanding of the bill as well as generally accepted actuarial standards of practice including the following:

1. Costs were developed using the same membership data, methods, assets and assumptions as those used in preparing the preliminary September 30, 2005, actuarial valuation report of the Law Enforcement Officers' and Fire Fighters' Retirement System.
2. As with the costs developed in the actuarial valuation, the emerging costs of the System will vary from those presented in the valuation report or this fiscal note to the extent that actual experience differs from that projected by the actuarial assumptions.
3. The analysis of this bill does not consider any other proposed changes to the system. The combined effect of several changes to the system could exceed the sum of each proposed change considered individually.
4. This draft fiscal note is intended for use only during the 2007 Legislative Session.
5. Plan 2/3 utilizes the Aggregate Funding Method. The cost of Plan 2/3 is spread over the average working lifetime of the current active Plan 2/3 members.
6. Entry age normal cost rate increases are used to determine the increase in funding expenditures for future new entrants. Aggregate rate increases are used to calculate the increase in funding expenditures for current plan members.

GLOSSARY OF ACTUARIAL TERMS:

Actuarial accrued liability: Computed differently under different funding methods, the actuarial accrued liability generally represents the portion of the present value of fully projected benefits attributable to service credit that has been earned (or accrued) as of the valuation date.

Actuarial Present Value: The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions (i.e. interest rate, rate of salary increases, mortality, etc.)

Aggregate Funding Method: The Aggregate Funding Method is a standard actuarial funding method. The annual cost of benefits under the Aggregate Method is equal to the normal cost. The method does not produce an unfunded liability. The normal cost is determined for the entire group rather than an individual basis.

Entry Age Normal Cost Method (EANC): The EANC method is a standard actuarial funding method. The annual cost of benefits under EANC is comprised of two components:

- Normal cost; plus
- Amortization of the unfunded liability

The normal cost is determined on an individual basis, from a member's age at plan entry, and is designed to be a level percentage of pay throughout a member's career.

Normal Cost: Computed differently under different funding methods, the normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year.

Pension Benefit Obligation (PBO): The portion of the Actuarial Present Value of future benefits attributable to service credit that has been earned to date (past service).

Projected Benefits: Pension benefit amounts which are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

Unfunded Liability (Unfunded PBO): The excess, if any, of the Pension Benefit Obligation over the Valuation Assets. This is the portion of all benefits earned to date that are not covered by plan assets.

Unfunded Actuarial Accrued Liability (UAAL): The excess, if any, of the actuarial accrued liability over the actuarial value of assets. In other words, the present value of benefits earned to date that are not covered by plan assets.